

**SHEPHERD & SMITH, P.C.**

**ATTORNEYS AT LAW**

1314 TEXAS AVENUE, 20TH FLOOR  
HOUSTON, TX 77002

HOUSTON, TX: (713) 227-2400  
TELECOPIER: (713) 227-7215

TOLL FREE (800) 259-9010  
BEAUMONT, TX: (409) 838-1000

July 7, 2000

Honorable John Dingell  
Ranking Minority Member, Committee on Commerce  
U.S. House of Representatives  
Washington, D.C. 20515

Honorable Edward J. Markey  
U.S. House of Representatives  
Washington, D.C. 20515

Honorable Nick Lampson  
U.S. House of Representatives  
Washington, D.C. 20515

RE: GAO REPORT: *ACTION NEEDED TO ADDRESS PROBLEM OF UNPAID  
SECURITIES ARBITRATION AWARDS*

Dear Sirs:

Thank you for your sincere and diligent efforts to make the investment world a better place for millions of Americans. I received and read the GAO report on unpaid securities arbitration awards and was pleased that this problem is under consideration but was appalled by the insipid and wholly inadequate recommendations made to Congress in that report.

I address this to my Congressman and old friend Nick Lampson, but let me introduce myself to you, Congressmen Dingell and Markey. I am now in my second career as a securities arbitration attorney. For more than twenty years I was associated with brokerage firms as an investment banker and Vice President of Merrill Lynch and Smith Barney. I left that business more than ten years ago and, having a law degree, then attended Georgetown University Law Center there on Capital Hill, where I received a Masters in Law in Securities Regulation. (This was my second stay on the Hill, since I had worked in the 1960's as an administrative assistant to Hon. Jack Brooks and for the House Judiciary Committee.) My firm has a staff of ten, many who also have a background in the brokerage business, and we handle about 30% of all securities arbitration matters in the Southwest.

We discuss potential claims against brokers and their firms with an average of more than one investor per day. We are unfortunately only able to assist about one of five investors who contact us. While many simply do not have a viable case, an overwhelming number of claims can not be pursued because the firms are "fly-by-night" operations, either out of business or "on the ropes".

July 7, 2000  
Honorable John Dingell  
Honorable Edward J. Markey  
Honorable Nick Lampson  
P.2

My firm has "won" millions of dollars in uncollectible awards for investors, and have actually put several firms out of business. The vast majority of our cases are pursued on "contingent" fees, such that I have myself lost well in excess of a million dollars in fees when firms have ceased operations, either during the proceedings or after awards have been issued. Meanwhile, many claims must be settled quickly, for a fraction of the losses, when it is apparent that firm will soon fold or not have funds to pay any adequate award.

Our experiences with such firms is far from unique! I am a member of the Public Investors' Arbitration Bar Association (PIABA), an organization of more than a hundred attorneys and others who communicate regularly on such issues. Each year we meet and exchange experiences, as a group and informally. Collectively, we have "won" tens of millions of dollars of uncollectible awards for clients, been forced to abandon an even greater amount of claims and are forced daily to sadly explain to countless investors that there is no feasible way to recover their losses.

Regulators, including the NASD, the exchanges and the SEC pursue a few hundred investor complaints each year, issuing wrist-slaps to those who are actually fined. Meanwhile, almost 5,000 securities arbitration claims are filed annually, the majority of which result either in awards or settlements to investors. (While the awards are usually woefully inadequate, I will save that discussion for another day.) Despite the "fanfare" of investigations, fines and arrests by regulators and law enforcement officials, securities regulation is left mostly to us "private attorney generals". The alternatives are: (1) Spend more taxpayers dollars on police; (2) Place the "fox in charge of the henhouse" with so-called self-regulation; or, (3) Maintain a framework of civil laws which permit wronged investors to seek damages from the perpetrators. While all three sources of regulation are important, it should be noted that private causes of action are the most widespread and efficient means of deterring fraud, while also recovering damages for investors. But we, the primary "regulators", can not do our jobs without a source from which to recover for these investors.

Who are the victims of broker and brokerage firm misconduct? There is no true prototype. My firm has represented men, women and children, 5 years old to 95 years old, students to retirees, disabled blue collar workers and emigrants to professionals, republicans and democrats, individuals, corporations, schools, governments and churches. What these investors have in common is that each sought out, or was sought out by, what was believed to be a professional to assist with investments. Each invested both assets and trust with brokers and firms who, instead, took advantage of them. When that trust is broken, investors often experience life changing circumstances, many being faced with financial insecurity as well as humiliation and even guilt. As PIABA's recently elected, but soon deceased, president so eloquently stated in his acceptance speech at our last convention: "These people have lost not only their savings but their dignity".

July 7, 2000  
Honorable John Dingell  
Honorable Edward J. Markey  
Honorable Nick Lampson  
P.3

The real tragedy of this situation is that it is entirely solvable, but certainly not through the GAO's recommendations to you! The only reason this problem has not already been solved is its "David vs. Goliath" aspect. Who wants change? The little guys, who do not realize that change is needed until it is too late, and their ever more unpopular lawyers. Who wants to maintain the status quo? The mega-billion dollar investment industry, which collectively pays little more than one cent per dollar of its revenues on claims, less than it does for stamps. More than a half-million persons claim to be investment professionals, meaning only one in one hundred have any claim filed against them each year. Most brokers are honest and a huge percentage of the actionable fraud is being perpetrated by the proliferating "sweat shops" and their brokers. Incidentally, the primary problem lies with the principals of such firms, not the so-called "rogue brokers". These are the people who put together bogus offerings, while the brokers are trained in other fraudulent practices. This is a wholesale intolerable problem which dwarfs all other telephone fraud activities combined.

Why would the mainstream firms not want these practices to end? If you ask, you will learn that the crooks keep the regulators overwhelmed. This is a plus for larger firms who are therefore regulated less. But change is primarily resisted because the low capitalized small firms could not exist without larger "clearing firms" which perform the more expensive back office operations. Who owns the clearing firms? Wall Street. Before my careers in law and investments, I was a banker. I learned long ago that any bank which can make 200% collateralized loans at 3% to 5% greater interest than its cost of money, and with the power to liquidate the loan collateral instantly if the value of that collateral falls below 130% of the loan, has a "license to coin money". Clearing firms earn billions in interest from clients of fraudulent small firms, while charging execution fees and otherwise sharing in the profits from the fraudulent activities. Before new rules were instituted in 1983, clearing firms were often held liable for the acts of the introducing firms. Therefore, solution number one is to reverse the rules exempting clearing firms from liability so that these firms have an incentive to police the activities of the introducing firms, through whom they earn billions of dollars.

There is a second solution also available. If introducing firms were required to carry insurance covering their wrongful acts, such as states require for motorists, victims could be reimbursed for their losses. The cost of insurance would be borne by introducing firms, making them responsible in advance for their actions. Based on normal insurance principals, bad behavior would translate to higher rates, causing the worst behavior to be financially excluded. This would shift some regulation to the insurance carrier(s), who would necessarily monitor just which firms they would insure.

Moreover, there is already one insurance company in place to do this. The Securities Investors' Protection Corporation (SIPC) is a quasi-governmental insurance company with more than a billion dollars in reserves, but which pays few claims. Many investors believe, in fact many are actually told, that their accounts are insured "should anything go wrong". The victim learns only after he or she has lost money that this insurance does not protect against broker wrongdoing, only

July 7, 2000  
Honorable John Dingell  
Honorable Edward J. Markey  
Honorable Nick Lampson  
P.4

for claims of funds actually purloined from accounts. All that is necessary is to universally raise SIPC fees either on a per firm, per broker or per asset value of the accounts basis, in order to cover all types of claims. This change would also create a far greater incentive for all firms on Wall Street to police not only their own brokers and supervisors but also the entire industry, as they would strive to lower the cost of this insurance.

These simple solutions are not without some cost. Yet, those costs already exist but are being borne by the innocent victims, instead of the perpetrators of the fraud along with those who benefit from these fraudulent activities. The important task which should be accomplished is for fraud to be cost prohibitive to the crooks and their accomplices before the fraud occurs, not to the victims after the fact. This is the American way, to have financial considerations determine outcomes - the free market society at work. Both conservatives and liberals should identify with such solutions which do not entail additional costs to the taxpayers. Furthermore, this is a timely election issue for Congress: "Investors' Rights".

As I earlier mentioned, there are many other issues concerning securities arbitration which must be addressed, primarily the pool of arbitrators and the selection process, but addressing the issue of uncollectible awards, along with awards which never actually occur since most cases must be abandoned or never filed, is essential; and, solutions are available. While the pocketbooks of a hundred or so arbitration lawyers and broke victims is minuscule compared to Wall Street, more voters are investing today than at any time in history. Shine the light on this problem and pressure can be brought on other elected representatives to take action.

Again thank you for your continued efforts on behalf of investors. I am available to answer questions you or your staff may have in this regard, as I know are other members, officers and directors of PIABA. While I do not speak for that organization or its members as I write, I can assure you that this is of primary importance to each of us and, more importantly, to millions of defrauded, and soon to be defrauded, investors.

Yours very truly,



William S. Shepherd

WSS/kw

cc: All PIABA members, via e-mail.